No. 356

IN THE

Supreme Court of the United States

OCTOBER TERM—1947

PEDRO SANCHEZ,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

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Authorities Cited:

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Commissioner of Internal Revenue v. Pedras Negras, (127 Fed. 2nd 260, C. C. A. 5th) 9, 10

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TO THE HONORABLE FRED M. VINSON,
Chief Justice of the United States,
and the Associate Justices of the
Supreme Court of the United States:

Your Petitioner, PEDRO SANCHEZ, respectfully prays for a Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit, to review a judgment of that Court entered on June 21, 1947, affirming a decision of the Tax Court of the United States, entered on June 27, 1946, which affirmed two deficiencies assessed against the Petitioner-Taxpayer with respect to his Income Tax Return for the calendar year 1940. This petition and the review sought thereby shall be confined to one of said deficiencies, namely, the deficiency of $8,678.30.

Statement of Matters Involved

Petitioner, a non-resident alien individual, filed his Federal Income Tax Return for the calendar year 1940 with the Collector of Internal Revenue for the Second District of New York. Omitted therefrom was an item of $8,678.30. In omitting this item, the Petitioner took the position that it constituted royalties based upon the use of a patented process in several foreign countries and was, therefore, in come from a source outside the United States and non-taxable to the Petitioner. The Respondent determined that the exclusion of this income was a deficiency in that the source thereof was within the United States (p. 5).

This determination was affirmed by the Tax Court and by the United States Circuit Court of Appeals for the Second Circuit.

Nature of Controversy

The Petitioner is the inventor of a process used in the chemical treatment of sugar involving the use of a chemical reagent. Both the process and the chemical reagent are covered by world-wide patents (pp. 5, 6, 57). The Petitioner, by a series of agreements, ultimately assigned his rights to his patented process to Sucro-Blanc, Inc., a New York corporation, reserving unto himself the right to receive royalty payments based upon the use of the process by persons, firms or corporations dealing with said Sucro-Blanc, Inc. (pp. 57, 58).

Sucro-Blanc, Inc. sold to its various customers, in a number of foreign countries, the patented product necessary to the use of the patented process, but granted, along with such sales, licenses for the use of the process by such

customers (pp. 8, 9, 10). Pursuant to his agreement with Sucro-Blanc, Inc., the Petitioner was entitled to and did receive 10% of the selling price of the sale by Sucro-Blanc, Inc. of the patented product necessary to the patented process (pp. 8, 54).

All of the sales in question were made to persons in foreign countries; the products so sold were for use in foreign countries and the licenses thereby granted were utilized in foreign countries (pp. 8, 9).

The Respondent has determined that income to the Petitioner, based upon the foregoing facts, during the calendar year 1940, amounting to $8,678.30, constitutes income from sources within the United States, and this determination has been affirmed by the Tax Court and by the United States Circuit Court of Appeals for the Second Circuit.

Question Presented

The sole question presented is whether the income of $8,678.30 constitutes income from sources outside the United States and therefore non-taxable to the petitioner, a non-resident alien individual.

Reasons for the Allowance of the Writ

1. The United States Circuit Court of Appeals below has used the wrong criteria in determining the question presented, and has thus promulgated several rules of law which are untenable and contrary to an Act of Congress.

2. The United States Circuit Court of Appeals below has interpreted an important statute, and has thus decided an important question of Federal law which has not been, but should be, settled by this Court.

The foregoing reasons are discussed in the appended brief.

WHEREFORE, your Petitioner prays that a Writ of Certiorari issue to the United States Circuit Court of Appeals for the Second Circuit demanding said Court to certify and send to this Court, on a day to be designated, a full and complete transcript of the record and all proceedings of said Circuit Court of Appeals had in this cause, to the end that this cause may be reviewed and determined by this Court; that the judgment of the Circuit Court of Appeals be reversed; and that the Petitioner may be granted such other and further relief as may seem proper.

Dated: New York, N. Y.,
September 17, 1947.

PEDRO SANCHEZ,
Petitioner.

By: MILTON R. WEXLER,
Counsel for Petitioner.

HARRY L. GUTTER
ARNOLD H. SHAW
of Counsel

IN THE

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Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinions Below

The opinion of the Tax Court of the United States below is reported in 6 T. C. 1141.

The opinion of the Circuit Court of Appeals below is reported in 162 Fed. 2nd 58.

Jurisdiction

The judgment of the United States Circuit Court of Appeals for the Second Circuit, now sought to be reviewed, was entered on June 21, 1947. The jurisdiction of the Supreme Court of the United States is invoked under Section 240 of the Judicial Code, as amended, also known as Title 28 U. S. Code, Section 347 (a).

Statute Involved

Section 119 of the Internal Revenue Code (Title 26 U. S. Code, Section 119), so far as same is applicable to the question at bar, provides as follows:

"Section 119. Income from sources within United States.

(a) Gross income from sources in United States. The following items of gross income shall be treated as income from sources within the United States:

* * * * * *

(4) Rentals and Royalties.

"Rentals or royalties from property located in the United States or from any interest in such property, including rentals or royalties from use or for the privilege of using in the United States, patents, copyrights, secret processes and formulas, goodwill, trade-marks, trade brands, franchises and other like property; and

* * * * * *

(c) Gross income from sources without United States.

The following items of gross income shall be treated as income from sources without the United States:

* * * * * *

(4) Rentals and Royalties.

"Rentals or royalties from property located without the United States or from any interest in such property, including rentals or royalties for the use of or for

the privilege of using without the United States, patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises and other like property."

Statement of the Case

A summary statement of the case is set forth in the Petition. In the interests of brevity, and in compliance with Rule 38 of the Rules of this Court, this statement will not be repeated in this brief, but reference thereto is hereby made.

Specification of Errors

1. The Circuit Court of Appeals erred in sustaining the deficiency which involves the inclusion of income earned from sources outside the United States based upon the privilege of using a patented process by foreign licensees in foreign countries.

2. The Circuit Court of Appeals erred in determining that the place of the sale of the patented process was determinative of the sources of the Petitioner's income.

3. The Circuit Court of Appeals erred in not holding that the sources of the Petitioner's income were determined by the place where the privilege of using the patented process was exercised.

4. The Circuit Court of Appeals erred in not holding that the sales of the product in question were merely selected by Petitioner and his assignee as a suitable means whereby the amount of royalty income to the Petitioner may be measured.

5. The Circuit Court of Appeals erred in not holding that Sucro Blanc, Inc. was merely the instrumentality through which the Petitioner received royalty payments rather than the source of royalty payments to the Petitioner.

6. The Circuit Court of Appeals erred in not holding that the product in question was sold merely as an incident to the granting of licenses for the use of the patented process in foreign countries.

7. The Circuit Court of Appeals erred in not holding that the place of sale of the patented product is irrelevant and immaterial to the question of source of income where the patent is used in foreign countries.

8. The Circuit Court of Appeals erred in not holding that the place of manufacture of the patented product is of no consequence as to the question of source of income where the patent is used in foreign countries.

Summary of Argument

The effect of the decision of the Circuit Court of Appeals is to disregard the criterion for determining the source of income derived from the use of a patent, as provided in Section 119, Internal Revenue Code.

THE ARGUMENT

The effect of the decision of the Circuit Court of Appeals is to disregard the criterion for determining the source of income derived from the use of a patent as provided in Section 119, Internal Revenue Code.

We begin with the proposition that the situs of the place where a patent is exercisable is the sole and crucial test in determining the source of payments derived from such use. Section 119(c) (4), Internal Revenue Code, *supra*. It is significant that the foregoing statute is silent as to the manner in which the royalty is to be paid. No mention is made concerning the place where it is paid and the situs of any contract or agreement relative thereto. Nor is mention made of the place where the patented process is manufactured. Only the situs of the place where the patent is actually used is the material factor. (*Commissioner of Internal Revenue* v. *Pedras Negras,* 127 Fed. 2d 260, C. C. A. 5th.)

Notwithstanding the undisputed facts that the patents in question were utilized in a number of foreign countries, the courts below have held that the income derived from such use constituted income from a source within the United States, since certain contracts with respect thereto were executed in the United States and the moneys were actually paid to Petitioner by a domestic corporation.

It follows, that in basing their decisions on such factors as place of sale, place of payment and place of manufacture, the Courts below have disregarded the only criterion expressly provided for in the statute, namely, the place of use of the patent.

It is submitted that where, as in the case at bar, a license governing the use of a patent is granted, in determining the

source of royalty payments thereunder, the place where the licensing contract is made and the place where the product necessary to the process is manufactured are inconsequential factors which cannot be read into the clear, unambiguous and simple language of Section 119(a) (4) of the Internal Revenue Code, *supra*.

Nor can it be held, as the Courts below have held, that the income has a domestic source on the ground that the patented product used in the patented process was manufactured in the United States and the money paid in the United States by an American corporation. (*Commissioner of Internal Revenue* v. *Pedras Negras, supra;* I. T. 2735, XII, C. B. 131.)

The precise question presented warrants settlement by this Court, since it involves the interpretation of an important Federal Statute, and the promulgation of an important rule of Federal law.

CONCLUSION

For the reasons stated in the petition and in this brief, it is respectfully submitted that the application for a writ of certiorari should be granted.

Respectfully submitted,

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